

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 05-0031
Corporate Income Tax
For the Years 2000 and 2001

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ISSUE

I. Gross Income Tax—Royalty Income from trade names, trademarks, and other intellectual property

Authority: IC 6-8.1-5-1(b); IC 6-2.1-2-2; 45 IAC 1-1-51.

Taxpayer protests the imposition of Gross Income Tax on royalties receipts.

II. Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 15-11-2(b) and (c).

Taxpayer requests an abatement of penalties

STATEMENT OF FACTS

Taxpayer is a wholly-owned subsidiary of a manufacturer. Taxpayer is domiciled in North Carolina and its sole business is the ownership and administration of trade names, trademarks, service marks, and related trademarks formally owned by the parent in its business. Parent pays Taxpayer 4.5% of its sales revenues in exchange for Parent's use of the intellectual property.

Parent filed amended income tax returns for 1997, 1998, and 1999. The Department denied the refunds claimed by Parent and conducted an audit for 2000 and 2001 of Parent and Taxpayer. Taxpayer was issued a gross income tax assessment on the royalties paid by Parent on Indiana revenue sales.

Taxpayer protested the assessment. A hearing was held. The determination of the assessment issues is binding upon the refund claims.

I. Gross Income Tax—Royalty Income from trade names, trademarks, and other intellectual property

DISCUSSION

All tax assessments are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b).

Indiana imposed gross income tax on the taxable gross income of a taxpayer which is a resident or domiciliary of Indiana and on the taxable gross income from Indiana sources by a taxpayer who is not a resident or domiciliary of Indiana. IC 6-2.1-2-2.

Under the regulation governing the gross income tax, “taxable gross income” includes income that is derived from intangibles. 45 IAC 1-1-51. The term “intangibles” includes royalties. *Id.* In order for Indiana to impose the gross income tax on income derived from taxpayer’s intangibles, the Department must determine that the income is derived from a “business situs” within the state. *Id.* The regulation states that a taxpayer has established a “business situs” within the state if the intangible or the income derived from the intangible forms an integral part of a business regularly conducted at a situs in Indiana. *Id.* Once the taxpayer has established a “business situs” within the state, and the intangible or the income derived from the intangible is connected with that business, either actually or constructively, the gross receipts of those intangibles will be required to be reported for gross income tax purposes. *Id.*

The income derived from Taxpayer’s licensing of its intellectual property within the state is income derived from a “business situs” within Indiana and is properly subject to the state’s gross income tax scheme. The intellectual property is localized within Indiana because the intellectual is integrally related to the products sold within Indiana. The income at issue is not derivative of taxpayer’s out-of-state activity in developing, managing, and protecting the intellectual property; the value of this intellectual property lies in Taxpayer’s ability to license the property for use within Indiana, to maintain rigorous control over the use of the property, and to derive the economic benefits attributable to the intangible property’s Indiana business situs.

Taxpayer was paid royalties on the products sold within Indiana. It was the efforts of the company to promote products within Indiana that generated the royalties. The value of the intangibles is inextricably tied to the company's efforts. Taxpayer received royalties based upon the company's gross income received in Indiana. The amount of that gross income is directly attributable to the success in marketing and labeling within Indiana. Taxpayer's gross income is a measure of the company's success within Indiana.

Because the intangible intellectual property has acquired a business situs within Indiana and because the income at issue is connected with that business, either actually or constructively, the income is subject to Indiana gross income tax.

FINDING

For the reasons stated above, Taxpayer's protest is denied.

II. Penalty

DISCUSSION

Taxpayer asks the Department to abate the 10% negligence penalties because the position of Taxpayer and its Parent for the audit years in question were based upon reasonable and proper interpretation of both state and federal law.

IC 6-8.1-10-2.1 requires that a 10 % penalty be imposed if the tax deficiency results from the taxpayer's negligence. 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." *Id.*

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed"

Taxpayer has not shown it used the "ordinary business care and prudence" expected of an "ordinary reasonable taxpayer" that would warrant abatement of the negligence penalty.

FINDING

For the reasons stated above, Taxpayer's protest is denied.

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